

STATES OF JERSEY



GOODS AND SERVICES TAX: EXEMPT OR ZERO RATED ITEMS (P.165/2005) – COMMENTS

**Presented to the States on 27th September 2005
by the Finance and Economics Committee**

STATES GREFFE

COMMENTS

Introduction

Senator Syvret's Proposition (P.165/2005) seeks to exclude the following items from the scope of the Goods and Services Tax (GST) which the States has agreed will be introduced in Jersey in 2008 –

- (a) basic foodstuffs;
- (b) children's clothing;
- (c) medical services and products;
- (d) books and newspapers.

Members will recall that Senator Syvret proposed the same exclusions in an amendment to the Committee's Fiscal Strategy (P.44/2005) as recently as May this year. Then, after 3 days of exhaustive debate, the States voted with clear majorities of 32 to 14 against excluding basic foodstuffs, children's clothing and books and newspapers; and by 29 to 17 against excluding medical services and products.

The Committee is surprised and disappointed that within the space of 5 months there is now a proposition to reverse these clear States' decisions. The Committee published its comments on Senator Syvret's proposed changes in May, and stands by them today. A copy of those comments is attached as an Appendix and members are urged to acquaint themselves with them.

The Committee can see nothing in the current proposition that would cause it to revise any of the points made in those earlier comments. The Committee is extremely concerned about the accusation that its arguments are "*mendacious*". Untruthfulness, or lying, which is what the Committee is being accused of, is a very serious accusation and one which should never be made lightly. The Committee takes great exception to having its honesty impugned in this way and absolutely refutes any such accusation.

The Committee believes that this debate is taking place at entirely the wrong time. There is much technical and detailed work to be done on the design of the Goods and Services Tax and Crown Agents will, over the next 12-18 months, be undertaking a comprehensive social impact study on the effects of this tax on our community. The Committee is of the firm opinion that any debate on the scope of the tax should wait for this important work to be completed. Decisions on what is best for Jersey can then be taken by States Members in an informed and considered manner which properly takes into account all the research and analysis. Any decision today cannot be as well-informed and runs the very real risk of being thoroughly ill-judged.

Having made these points the Committee will address the specific issues contained in P.165/2005.

Use of U.K. business systems and case law

The proposition claims that the Committee's arguments for the complexity that would follow from the exclusions are a "*travesty of overblown scaremongering and obsolete*". It then goes on to say that any issues could easily be resolved by use of U.K. business systems and case law.

U.K. business systems and case law (assumed to mean "precedent" case law rulings after appeals to a VAT Tribunal, the High court and/or a European Court) are really different issues but both are linked to the enabling legislation in the U.K.. The current U.K. legislation must now be compliant with various EU VAT directives to support the single market and the move towards harmonisation. The intention in Jersey is to start with a system that is simple and not to inherit a system that is riddled with complexity and is driven by different high level goals. If U.K. "business systems" includes (or is directed to) the operational support systems of the administration then it should be noted that they are currently subject to major review as part of the ongoing merger of HM Customs and Excise and the Inland Revenue. There is nothing of any substance that could be replicated in Jersey.

In fact the only logical way to apply U.K. case law and business systems would be for Jersey's GST to mirror the U.K.'s VAT. Jersey would therefore be inextricably tied into every policy decision and nuance of U.K. VAT. This is a quite astounding suggestion. The Committee finds it hard to believe that anyone could seriously suggest that any part of the Island's tax regime should be controlled in this way. The reasons for shaping U.K. VAT may well be applicable there but this does not mean that those reasons are right for Jersey. The Island always has, and should always continue to have, control over its own fiscal affairs.

Moreover this suggestion is an implicit acceptance that the exclusions **will** increase complexity. Thus the Senator moves towards the accepted wisdom in the rest of the world that the more exclusions there are the more complex the tax will become to administer for both government and business and the more opportunities there will be for non-compliance.

The Committee would remind members of the table on the very last page of the Appendix to these comments which shows the rates of VAT/GST applied in the 25 European Union states, together with Singapore and New Zealand. It is quite apparent that if any country is out of step it is the U.K. and that the general accepted practice worldwide is to tax those goods and services which the Senator is proposing should be exempt or zero-rated. The one exception is medical services which are generally exempt. In all these matters the Committee will take note of the outcomes of the forthcoming research and development work being undertaken by Crown Agents. It would be wrong to now impose any limitations on that work, but at the present time the Committee believes that Jersey's current arrangements for subsidising doctor's bills offer a much more satisfactory, and simpler, solution.

Regressivity

On the question of regressivity, the Committee has nothing to add to its earlier comments where it agrees that the Crown Agents' design for a GST is slightly regressive. Members are encouraged to look again at the tables included with the earlier comments which clearly demonstrate this point (see section 3 of the Appendix).

GST is a new and additional burden

The proposition is very critical of the GST for being "*a new and additional burden upon the great majority of people in our society*". But this should come as no surprise – all taxes create a burden and consumption taxes are actually intended to spread this burden throughout the whole of society. Tax revenue can only be raised if somebody pays it. What the Committee has said, and reiterates, is that whilst it wishes to spread the tax burden, it is determined that the poorest in our society will be protected from this burden. That is precisely why the Income Support Scheme is such an important and integral part of the Fiscal Strategy.

Is the 3% rate bound to rise?

The proposition claims that "*it is a fact*" that the rate of tax will rise from 3%. This is a most curious assertion. A fact is something that has already occurred and is irreversible, which is obviously not the case when discussing an increase in the 3% rate. The Committee has, however, given a solemn undertaking that the rate will be fixed for at least 3 years after the introduction of the tax in 2008. If the rate is re-appraised in 2011, or at some future date, it will be States Members themselves who, taking all circumstances into account, will decide upon any changes. The Committee will not make any predictions on what those circumstances will be and fails to see how anybody else can confidently predict fiscal measures or the political response so far in advance.

Suggested alternative tax measures

The report in P.165/2005 lists alternative taxes that could be applied in order to replace the revenue that would be lost by introducing the exclusions. The Committee would make the following comments on these taxes:

- "*A tax surcharge*"
A form of Income Tax surcharge was actually proposed at the time of the Fiscal Strategy debate in May and resoundingly rejected by members (see P.81/2005).

- *“Higher sales taxes upon luxury items”*
Exactly the same arguments for keeping exclusions to the minimum can be made against higher rates for luxury items - problems of definition will lead to complexity of administration. They would also potentially hit the less well off the hardest because they will spend proportionately more of their income on “luxury” items.
- *“Phasing out the ceiling on social security payments”*
This was another proposal made at the time of the Fiscal Strategy debate in May and also resoundingly rejected by Members due to the negative effects on economic growth and acting as a tax on jobs (see P.82/2005).
- *“Development taxes”*
The Committee has already agreed to examine development gains taxes and report back to the States.
- *“Land Value Tax”*
The Committee has already agreed to examine Land Value Tax and report back to the States.
- *“Ceasing the practice by which the payment of tax in Jersey by the rich is essentially a voluntary act”*
The payment of tax in Jersey by the rich is not a voluntary act. All 1(1)ks who have obtained entry to Jersey in the past have entered into an agreement with the States of Jersey and the vast majority of those who have done so have kept to the terms of their agreements and paid the tax properly due under such agreements. In last December’s Budget, tax matters in relation to 1(1)ks were formalised so that all 1(1)ks who enter Jersey from 2005 onwards are subject to the provisions of a new Article 135A in the Income Tax Law.
- *“Closing widely abused loopholes such as converting entire wealth streams into capital gains, thus avoiding tax completely”*
Article 134A of the Income Tax Law allows the Comptroller of Income Tax to challenge transactions where he is of the opinion that the main purpose, or one of the main purposes, of the transaction is the avoidance and reduction of the liability of any person to income tax. The Comptroller regularly does challenge such transactions and details of this has been made public in answers given to questions asked in the States Assembly on 30th March 2004, 11th May 2004 and 28th September 2004.

Administration costs

The Financial and Manpower Statement in P.165/2005 challenges the Committee’s estimates of cost and manpower. The estimates were provided by Crown Agents who produced the prototype design for the GST. Crown Agents stressed that the figures they provided were indicative and were based on their experience of the introduction and application of GST style taxes elsewhere in the world. The cost for the administration of the tax is judged to be £0.5 million per annum with 10 extra staff.

Crown Agents make it absolutely clear that these indicative staffing numbers are dependent on a simple GST, deployment of the current Income Tax Department compliance resources and utilisation of modern information technology/e-governance systems. They have no hesitation in advising that the extra complexity caused by the exclusions would cause administration/staff costs to double (see section 6 of the Appendix).

Conclusion

Members have already shown that they agree with the Committee that these exclusions should not be given and in May signified this agreement by voting for the Fiscal Strategy with a two to one majority. The Committee is dismayed that the issue has been brought back so soon after this clear decision.

The Committee reiterates that its Fiscal Strategy contains a package of measures and must be looked at in the whole. It is convinced that the measures in the Strategy are the fairest way to raise the revenue and, importantly, they have been carefully designed so that, together, they are broadly progressive.

In summary the Committee believes this proposition should be rejected because –

- any debate on exclusions should await the outcome of further work, especially Crown Agents' social impact survey;
- there should be no need for the exclusions because the Fiscal Strategy has been designed to be broadly progressive;
- the complexity introduced by the exclusions would significantly increase the administration costs;
- applying U.K. case law and business systems is not an option which will automatically be suitable to the Jersey economy and tax systems given their different structure from that of the U.K.;
- the alternative tax measures proposed to replace the lost revenue have either i) been previously rejected, ii) are being explored anyway or iii) are already in place.

The Committee asks Members, once again, for their support and to reject the proposition out of hand.

STATES OF JERSEY



FISCAL STRATEGY (P.44/2005): AMENDMENT (P.44/2005 AMD.)– COMMENTS

**Presented to the States on 19th April 2005
by the Finance and Economics Committee**

STATES GREFFE

COMMENTS

1 Introduction

- 1.1 An amendment to paragraph (a)(i) of the Finance and Economics Committee's Fiscal Strategy (P.44/2005) was lodged by Senator S. Syvret on 15th March 2005. Paragraph (a)(i) of P.44/2005 outlines the Committee's proposals for a broad based Goods and Services Tax (GST) taken from the recommendations of its independent consultants Crown Agents.^[1]
- 1.2 In the amendment's report it is claimed that "*Sales taxes are highly regressive and impinge upon those least able to afford them*". The amendment seeks to remedy this by excluding from the tax basic foodstuffs, children's clothing, medical services and products and books and newspapers. It is also claimed that "*the few simple exemptions...ought not to create any additional expenses or manpower requirement*".
- 1.3 The problem is that the facts do not support these claims. This comment will show that a broad-based GST is not highly regressive, the exclusions listed are not simple and, if adopted, would significantly increase the cost of administration and compliance.
- 1.4 The report also recognises that "*a financial cost will exist in respect of the revenue foregone if the amendments are approved*". This point is addressed in section 2 and the claims in the amendment are addressed in sections 3 to 6.

2 "...the revenue foregone..."

- 2.1 Members will recall that the projected revenue from the broad based GST is £45 million. Crown Agents have estimated that the revenue that would be foregone if the amendments were approved would be over £5 million pounds before allowing for any extra administration costs (see section 6) and loss due to non compliance (see section 2.2). With the extra administration costs alone **the revenue foregone would be over £5.6 million.**^[2]
- 2.2 Crown Agents stress that based on international experience there would be an **additional shortfall in revenue directly as a result of non-compliance**. They regard the opportunities that would be introduced for non-compliance as the most damaging aspect of the proposed exclusions. It is impossible to forecast the additional revenue shortfall with any accuracy but the level would be linked to excluding certain types of supply. From the amendment's list of exclusions food most certainly would have the biggest impact but all would be problematic.
- 2.3 The amendment offers no specific or detailed measures to recoup the lost revenue, other than to vaguely suggest a "*variety of progressive taxes targeted at those who could afford them most*".^[3]

3 "Sales taxes are highly regressive..."

- 3.1 This is simply not the case. There are views that they are not regressive at all. Indeed the International Monetary Fund has stated: "*A single positive rate of VAT applied to the broadest possible base...is essentially a proportional tax on consumption*".^[4]
- 3.2 Nonetheless Crown Agents describe their prototype broad based Goods and Services Tax with a 3% rate as having a slight regressivity. They demonstrate this in Table 1 which shows the effect on Island households by comparing the expenditure on GST for each quintile^[5]. The table then compares that regressivity with the tax if it were amended as proposed.

Table 1 GST as a percentage of household expenditure by quintile

	Group 1	Group 2	Group 3	Group 4	Group 5
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Broad Based (3% rate)	2.5%	2.5%	2.4%	2.4%	2.4%
Amendment (3% rate)	1.9%	1.9%	1.9%	2.0%	2.1%

Source: Crown Agents

3.3 Alternatively, Table 2 uses income tax return data, within limitations of the available data, to show the impact on taxpayers in each quintile as a percentage of income. This shows that even with the amendment's exclusions there is a very slight regressivity.

Table 2 GST as a percentage of taxpayer income by quintile

	Group 1	Group 2	Group 3	Group 4	Group 5
Broad Based (3% rate)	2.2%	2.0%	1.9%	1.9%	1.9%
Amendment (3% rate)	1.7%	1.6%	1.6%	1.6%	1.6%

Source: Crown Agents

3.4 Tables 1 and 2 clearly show that the regressivity of the Crown Agents' broad based GST is so slight as to be negligible – it certainly cannot be termed highly regressive.

3.5 The amendment seeks to mitigate its claimed high regressivity by excluding a number of items from the tax, but again the tables illustrate that the effect of the exclusions is so small as to be virtually insignificant.

3.6 The amendment's report makes it clear that the purpose of the exclusions is to alleviate the impact of the tax on the less well-off. It is worth examining what that impact is on the households in the quintiles. Table 3 shows that the actual benefit that would be derived from the exclusions is extremely low, in fact the lowest income households would only benefit by £80 per year. In cash terms the households that would benefit most are those in the highest income quintile.

Table 3 Effect on household expenditure by quintile

	Rate	Group 1	Group 2	Group 3	Group 4	Group 5
Broad-based Proportion of untaxed household expenditure	3%	12%	15%	17%	17%	16%
Amendment Proportion of untaxed household expenditure	3%	34%	33%	33%	31%	28%
Annual decrease in GST borne		£80	£119	£148	£168	£217

Source: Crown Agents

4 *“Sales taxes... impinge upon those least able to afford them.”*

- 4.1 Table 3 clearly shows that the amendment's exclusions would not achieve much relief at all for the lower paid.
- 4.2 Crown Agents have commented on the use of exclusions to the tax as a means of helping the less well off and say: *“In our view, an income support scheme is by far the best way of alleviating the impact on the lower paid, rather than complicating the system with exemptions, etc.”*^[6]
- 4.3 The Committee fully endorses this view and has consistently said that the impact of any new taxes on those on lower incomes would have to be relieved by the new Income Support scheme. The Employment and Social Security Committee is due to lodge its proposals for the Income Support Scheme on 26th April.
- 4.4 The Finance and Economics Committee fully recognise and support the need to protect those in our community who are vulnerable and has taken great care to ensure that its overall tax package is fair and progressive.

5 *“...the few simple exemptions...”*

- 5.1 The amendment proposes to exclude basic foodstuffs, children's clothing, medical services and products and books and newspapers. Its report describes these proposed exclusions as “simple exemptions” whereas the opposite is the case and they are generally viewed as the most complex to define. (On a technical point when these items are not taxed in other countries they are ‘zero-rated’ as opposed to being made ‘exempt’).^[7]
- 5.2 On the face of it basic foodstuffs seems a reasonable exclusion from the tax, however it is universally accepted that they are the most complex type of goods to define. In the U.K. there are more rules, procedures, rulings and staff dedicated to the application of VAT on foodstuffs than any other goods or service. The reasons are obvious when thought, as these examples in paragraphs 5.3 and 5.4 show.
- 5.3 If it is decided that confectionery is not a “basic foodstuff” where should the line be drawn. If sweets are not a basic foodstuff, what about chocolate biscuits? If chocolate biscuits are excluded from the tax, what about cakes? If cakes are also excluded what about ‘Jaffa Cakes’, are they a biscuit or a cake? This is no mere idle speculation, the problem of defining ‘Jaffa Cakes’ was long and protracted in the U.K. and is very likely to be revisited.
- 5.4 Catering (including restaurant food) is normally taxed but should takeaways be included? Some food consumed off-premises is eligible for zero rating but then “premises” also needs to be defined. More problems emerge – what to do with food served for immediate consumption from mobile kiosks/vans or at ‘food fairs’ – are these to be taxed or not?
- 5.5 There are similar difficulties in defining children's clothing (e.g. will size be the only criterion? – in the U.K. the method of display is also important – to be eligible for zero rating the items must also be “put up for sale” as children's clothing – this often necessitates a dedicated area of a shop); medical services/supplies (e.g. will all alternative medicines be excluded?); and books and newspapers (e.g. does this include journals, periodicals, leaflets and will ‘top shelf’ magazines be in or out?).
- 5.6 These are just some of the challenges that will arise. Far from being “simple exemptions” more intricate and convoluted examples could not have been chosen. This is not hypothetical, it is based on well-documented live operational activities and experiences of GST/VAT administrations elsewhere in the world.
- 5.7 The added complexity would ensure many more rulings having to be made, requests for extra-statutory concessions, and appeals before independent Commissioners of Appeal – which would all take research,

time and care to prepare. There would have to be more control visits by Income Tax auditors to traders' premises to ensure the increasingly complex GST regime is being accounted for correctly. Any discovery of under declaration would lead to an assessment notice, and possibly penalties, which again would have to be subject to appeal. This would all lead to a spiral of control visits/compliance/ rulings/appeals which would be time consuming and contentious.

5.8 The Crown Agents have designed a simple system and the Committee accept their reasons for avoiding complexity. It is true that some countries have a number of exclusions or reduced rates in their GST or VAT, but it is generally accepted that the most successful application of these taxes is in countries that have a simple broad based tax with a single rate and a high threshold – similar to that proposed by Crown Agents. In fact the countries generally held up as a good model for a GST are New Zealand and Singapore, where exclusions have been kept to a minimum.

5.9 It is also interesting to note that the exclusions listed in the amendment are generally subject to positive rates in most of the E.U. member states.^[8]

6 “...[the exemptions] ought not to create any additional expenses or manpower requirement.”

6.1 Extra staff and more money would definitely be required if the amendment were to succeed.

6.2 The complexity of a GST/VAT style tax is a direct consequence of the amount of positive rates applied and the number of exempted and/or zero rated items. The more there are the more complex it becomes for government and business to administer and the more opportunity for avoidance. This leads directly to increased costs of collection/payment, compliance and regulation.

6.3 Administration costs for the Crown Agents prototype GST have been estimated at £500,000 per annum. Crown Agents estimate that a move to a GST with Senator Syvret's exclusions would cost £1 million per annum. In other words they would double.

6.4 Crown Agents estimated that 10 extra staff would be needed by the Income Tax and Customs Departments for the broad based GST. The amendment's proposed changes would move this requirement to approximately 20 additional staff between the 2 Departments.

7 Conclusion

7.1 The Committee has made it very clear that its proposals for the Fiscal Strategy should be taken as a package. The individual elements of taxation, economic growth and, crucially, Income Support have been designed to complement each other. Overall they produce a progressive effect.

7.2 It is common and perhaps understandable that the inexperienced eye will view GST/VAT types of taxes as inherently and highly regressive. However as this comment demonstrates at worst they could be slightly regressive and there is even an informed opinion that says they can be regarded as proportionate.

7.3 This comment shows that the effect of the amendment's exclusions would be to help the lowest income households by the modest sum of £80 per year. But at what cost? The increased complexity that arises in administration would double the government's costs from £0.5 million to £1 million and would double extra staff requirements from 10 to 20. The experience of the U.K. shows that business would also suffer from the increased complexity. In short the benefit simply does not justify the cost.

7.4 The Crown Agents have provided a prototype GST that they have designed specifically with Jersey in mind. At the very core of their design is the broad-based taxation of all consumption. This follows the current thinking for best practice in such taxes by keeping the rate of tax as low as possible and minimising the administrative burden to government and business. The Committee is convinced that this is the best solution for the community as a whole and that any adverse impacts on the less well-off are

better dealt with by targeted intervention through Income Support.

7.5 The current thinking in relation to the GST/VAT family of taxes can be succinctly summed up by this quote from the recent International Tax Dialogue Conference on the VAT –

“Exclusions by exemption/zero rating (other than exports) are inconsistent with the basic logic of VAT - amongst other things they reduce revenue, are not simple to administer and tend to creep”^[9].

7.6 Members are urged to reject the amendment.

VAT % RATES APPLIED IN EU MEMBER STATES (plus Singapore and New Zealand)

Annex

	Austria	Belgium	Cyprus	Czech Republic	Denmark	Estonia	Finland	France	Germany	Greece	Holland	Hungary	Ireland	Italy
Full Rate	20	21	15	19	25	18	22	18.6	16	18	19	25	21	20
Foodstuffs	10	6	0	5	25	18	17	5.5	7	8	6	15	0	4
Children's Clothing	20	21	15	19	25	18	22	19.6	16	18	19	25	0	20
Pharmaceutical products	20	6	0	5	25	5	8	2.1	16	8	6	5	0	10
Medical and dental care	exempt	exempt	exempt	exempt	exempt	exempt	exempt	exempt	exempt	8	exempt	exempt	exempt	exempt
Books	10	6	5	5	25	5	8	5.5	7	4	6	5	0	4
Newspapers	10	0	5	5	0	5	0	2.1	7	4	6	15	13.5	4

	Latvia	Luxembourg	Lithuania	Malta	Poland	Portugal	Slovakia	Slovenia	Spain	Sweden	UK	Singapore	New Zealand
Full Rate	18	15	18	18	22	18	19	20	16	25	17.5	5	12.5
Foodstuffs	18	3	5	0	3	5	19	8.5	4	12	0	5	12.5
Children's Clothing	18	3	18	18	22	19	19	20	16	25	0	5	12.5
Pharmaceutical products	5	3	5	0	7	5	19	8.5	4	25	0	5	12.5
Medical and dental care	exempt	exempt	exempt	exempt	7	exempt	exempt	exempt	7	exempt	exempt	5	12.5
Books	5	3	5	5	0	5	19	8.5	4	6	0	5	12.5
Newspapers	5	3	5	5	7	5	19	8.5	4	6	0	5	12.5

Note: Where there is more than one rate for any group then the lowest applicable rate is shown.

EU rates for Sen Syrett's amendment

Source: European Commission (2002/2005/2004) and New Zealand and Singapore Government websites

[1] Crown Agents, *Proposal for the Design of a Prototype Goods and Services Tax*, January 2005.

[2] Crown Agents emphasize that these figures and those included in the 3 tables in this comment are subject to the same caveats expressed in section 4.8 of their *Proposal for the Design of a Prototype Goods and Services Tax*.

- [3] Although not being proposed in the amendment members may find it interesting to note that if GST was to be used to recoup the lost revenue Crown Agents believe that to (a) produce the same target revenue yield, (b) recoup the loss of revenue from non compliance, and (c) cover the additional admin. costs, a 5% rate would probably be needed.
- [4] Ebrill et al, *The Modern VAT*, 2001, p. 106.
- [5] Each quintile has an equal number of households. Those in the first quintile have the lowest income per household while those in the fifth quintile have the highest income per household.
- [6] Crown Agents, *General Guide to GST in the form of Frequently Asked Questions*, February 2005, Q.37
- [7] Zero rating should not be confused with exemption. Exempt supplies are those that are not subject to tax (typically financial services, insurance and postal services). Businesses who make exempt supplies may not register for GST/VAT and therefore cannot recover GST on their business expenses. Any GST they incur sticks with them. Zero rated supplies are those transactions that are deemed to be taxable but at a zero rate. For social/political reasons this gives relief to the consumer on certain items while enabling the registered trader to recover VAT on business expenses. It provides the maximum possible benefit to businesses and traders alike but obviously has an impact on tax yield. Zero rating applies also to exports, thereby enabling exporters to be competitive in a world market.
- [8] A table showing the lowest rates applied to foodstuffs, children's clothing, medical services/products and books/newspapers in the E.U. member states (and Singapore and New Zealand) is annexed to this comment.
- [9] Professor Richard Bird, University of Toronto and consultant to the World Bank. (The International Tax Dialogue was the first global conference on VAT and was held in Rome on 15-16th March 2005. It was jointly organised by the OECD, the IMF and the World Bank and attended by approximately 100 countries.)